STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**04/21/03**	Bill No:	**SB 17**
Tax:	**Property**	Author:	**Escutia**
Board Position:		Related Bills:	**SB 3x (Escutia)**

BILL SUMMARY

This bill would:

- Require the Franchise Tax Board to furnish the Board of Equalization with the name and address of any entity that does not respond to a question concerning change in ownership on partnership, bank, and corporate tax returns. *§64*
- Require publicly traded companies to file annual real property statements with the Board of Equalization and imposes penalties for failure to file. *§471*
- Modify and increase the penalty assessed when a legal entity does not file a change in ownership statement with the Board of Equalization after a change in ownership under Section 64, subdivisions (c) and (d) due to a change in control of the legal entity. *§480.1, 480.2 and 482.*
- Make various legislative findings and declarations related to change in ownership of nonresidential commercial and industrial property.

Summary of Amendments

The prior version of this bill only contained the intent language that is still in the bill. This analysis will address the proposed law changes.

ANALYSIS

Current Law

A. Change In Ownership Definitions

Under existing property tax law, real property is reassessed to its current fair market value whenever there is a "change in ownership." (*Article XIIIA, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5)*

Revenue and Taxation Code Section 60 defines a "change in ownership" to mean a transfer of present interest in real property including the beneficial use thereof, and the value of which is substantially equal to the value of the fee interest.

Revenue and Taxation Code Section 64 sets forth the change in ownership provisions related to the purchase or transfer of **ownership interests <u>in</u> legal entities** that own real property. Generally, when real property is owned by a legal entity, the purchase or transfer of ownership interests in that legal entity does not trigger a change in ownership of the property.

An exception to this general rule is when there is a **"change in control"** of the legal entity or upon the transfer of more than 50% of "original coowners" interests. Subdivision (c) of Section 64 generally provides that a "change in control" occurs when **one person** or legal entity **acquires more than 50 percent** of the ownership interests in the legal entity. Subdivision (d) of Section 64 provides that if real property was excluded from a change in ownership when transferred into a legal entity under Section 62(a)(2) and the holders of the ownership interests became "original coowners" the subsequent transfer of more than 50% of those original co-owner's shares are transferred results in a change in ownership of the real property that was previously excluded.

B. Change in Ownership Reporting

Under existing law Sections 480.1 and 480.2 require a change in ownership statement to be filed by a legal entity when a change in ownership occurs under Section 64(c) or 64(d). Section 482 outlines penalties to be charged if the statement is not filed within 45 days of a written request by the Board of Equalization. The penalty is

- 10 percent of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity, *or*
- if no change in control or change in ownership occurred, 10 percent of the current year's taxes on that property shall be added to the assessment made on the roll.

However, the penalty is automatically extinguished if the person or legal entity files a complete statement described in Section 480.1 or 480.2 no later than 60 days after the date on which the person or legal entity is notified of the penalty.

To help discover changes in control of legal entities, information is requested on the state income tax return as required by subdivision (e) of Section 64. The Franchise Tax Board provides the information provided by taxpayers on the tax return form to the Board of Equalization.

Proposed Law

A. Change In Ownership Definitions

Presently, this bill contains legislative findings and declarations. This bill would state that because of difficulties in identifying changes in ownership of certain nonresidential commercial and industrial properties, these properties often escape reassessment at full market value upon a change in ownership.

B. Change in Ownership Reporting

Publicly Traded Companies. This bill would add Section 471 to the Revenue and Taxation Code to require publicly traded companies to file annual real property statements with the Board of Equalization. The bill would require a list of all of the real property owned or leased in the state by the company by March 1. If a company does not file the statement by April 15, then a 10% penalty based on the current year's taxes on all of the real property owned by the company in the state would be levied. Annually thereafter, reporting would be limited to transfers.

All Legal Entities. This bill would amend Section 480.1, 480.2 and 482 to modify the requirements and penalties for legal entities to file a change in ownership statement with the Board after a change in ownership under Section 64(c) and (d) due to a change in control of the legal entity. Specifically, it would:

- Extend from 45 to 60 days the number of days to file a statement upon a change in ownership and delete provisions for a second notice prior to the levy of the penalty.
- Require statements to list parcel numbers of affected properties.
- Change the agency for the deposit of penalties from the counties to the Board of Equalization.
- Delete provisions requiring statements upon demand of the Board.
- Delete automatic abatement of penalty if information is ultimately provided.
- Change the penalty from 10% of current year's taxes to the greater of 10% of current year's taxes or $10,000.
- Create a new penalty of greater than 25% of the current year's taxes or $25,000, if a legal entity misrepresents information on the change in ownership statement.

All Legal Entities. This bill would amend Section 64 to require the Franchise Tax Board to furnish the Board of Equalization with the name and address of any entity that does not respond to the change in ownership question on partnership, bank, and corporate tax returns.

In General

The Board of Equalization's Legal Entity Ownership Program (LEOP) was formed to assist in the discovery of changes in control and ownership of legal entities pursuant to subdivisions (c) and (d) of Section 64 of the Revenue and Taxation Code.

- Under Section 64(c) whenever a person or legal entity acquires more than 50% of the ownership interest in another legal entity, the real property of the acquired entity is reassessed.

- Section 64(d) provides that if real property was excluded from a change in ownership under Section 62(a)(2) when transferred into a legal entity and subsequently more than 50% of those original co-owner's shares are transferred, the real property that was previously excluded will be reassessed.

The LEOP unit assists assessors in discovering changes in ownership or control that might not otherwise be captured by a county's own discovery systems. Discovery of these changes is required by law and can be difficult because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity.

LEOP Operations

- Receives a list from the Franchise Tax Board of legal entities that have reported a change in ownership on their income tax returns or have left the question blank.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Sends a "Statement of Change in Control or Ownership of Legal Entities" to each entity.
- Analyzes completed statements to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Background

The Legal Entity Ownership Program (LEOP) started in January 1983 as a result of Chapter 1141 of the Statutes of 1981 (AB 152). The resulting Sections 480.1 and 480.2 of the Revenue and Taxation Code require the Board of Equalization to participate in the discovery of changes in control of corporations, partnerships, and other legal entities. It was recognized that such events, which are not evidenced by a recorded document, would fall outside the parameters of assessors' normal means for discovering changes in ownership.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Pacific Institute for Community Organization (PICO) www.PICOcalifornia.org and the California Tax Reform Association www.caltaxreform.org. Its purpose is to cause more frequent reassessment of nonresidential property to bring assessed values of impacted properties to current market value levels.

2. **Key Amendments.** The April 21 amendments relate to change in ownership reporting by legal entities. See the prior analysis for a full discussion of change in ownership of property owned by legal entities.

3. **This bill would require that publicly traded companies provide the Board with a list of real property they own in California.** When the Board discovers a change in ownership of a legal entity from a source other than through a company that independently files a change in ownership statement, this information could be used to provide a county assessor with information about properties subject to reappraisal located in his or her county. Currently, the Board does not have information about a legal entity's real property holdings in California.

4. **Some legal entities do not respond to the Board's request for information about potential change in ownerships.** The penalties for failing to respond can be automatically abated if the legal entity eventually responds. This bill deletes the automatic abatement provision. Some legal entities that file California income tax returns may not own or lease real property in California and would be subject to a penalty, without the possibility of abatement, if they failed to file the statement.

5. **In contrast to the income tax returns for income tax purposes, the requirement to file a change in ownership statement for property tax purposes is not widely known or understood.** Legal entities may not file statements, in part because the legal entity may not understand that for California property tax purposes, transfers of ownership interests in the legal entity have triggered a change in ownership. It is especially difficult for legal entities that have been granted a change in ownership exclusion under Section 62(a)(2). They fall into a special class that requires that cumulative transfers of interests be tracked after the excluded property transfer to determine when more than 50% of the total interests in the legal entity have been transferred. At that point, the company must report the change in ownership.

6. **The Franchise Tax Board currently informs the Board of legal entities that leave the property tax questions blank on their income tax returns**. This provision would codify existing adminstrative practices.

7. **The provisions requiring legal entities to file a change in ownership statement upon request should be restored.** As currently drafted, penalties would only apply if the company did not file a change in ownership statement after a change in ownership has occurred. However, in the discovery process the Board routinely sends statements to legal entities based on information from the state income tax returns and from monitoring various business publications. A requirement to file a statement and a penalty for failure to respond to the Board request for information should be retained.

8. **Related legislation.** Senate Bill 3x contains intent language identical to the intent language in this bill.

COST ESTIMATE

The Board would incur some minor absorbable costs in informing and advising local county assessors, the public, and staff of the law changes.

REVENUE ESTIMATE

This measure has no direct revenue impact. Increased penalties may be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs.

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